



United States  
General Accounting Office  
Washington, D.C. 20548

**Health, Education, and  
Human Services Division**

B-276629

May 20, 1997

The Honorable Thomas W. Ewing  
House of Representatives

**Subject: Student Loans: Potential Effects of Raising Statutory Audit Threshold**

Dear Mr. Ewing:

The Higher Education Amendments of 1992 required all lenders who participated in the Federal Family Education Loan Program (FFELP) to obtain an annual audit examining compliance with program rules and regulations. Typically, these lenders are banks and other institutions that make FFELP student loans that are ultimately guaranteed by the government against default or nonpayment. In the appropriations acts for the Department of Education for fiscal years 1996 and 1997, the Congress exempted from the audit requirement those lenders with loan portfolios of \$5 million or less (that is, the lender audit threshold was \$5 million). The Department has directed that lenders with loan portfolios of between \$5 million and \$10 million to submit their audit reports to the Department only if they contain findings that require corrective action. For those lenders whose portfolios exceed \$10 million, the Department requires submission of all audit reports.

You asked us for information about the potential effects of raising the audit threshold to lenders with loan portfolios that exceed \$10 million. As agreed with your office, we focused on identifying

- the number of lenders with loan portfolios between \$5 million and \$10 million, and the total loan volume in these lenders' portfolios; and
- the number, types, monetary impact, and disposition of audit findings reported to the Department of Education by lenders with loan portfolios in that range.

We obtained data for our analyses from the Department of Education, which administers FFELP. Student loan volumes were as of the end of fiscal year 1995, the most recent year for which data for such an analysis were available.

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We conducted our work between January and March 1997 in accordance with generally accepted government auditing standards.

### RESULTS IN BRIEF

If the loan volume audit exemption was extended to lenders with loan portfolios between \$5 million and \$10 million, relatively few of the more than 5,700 lenders participating in FFELP would be affected. In fiscal year 1995, 193 FFELP lenders (about 3 percent) had loan portfolios between \$5 million and \$10 million. These lenders held less than 2 percent of the total outstanding FFELP loan volume. If the audit threshold had been \$10 million for fiscal year 1995, the audit requirement would have applied to a total of about 9 percent of FFELP lenders—lenders that collectively held about 96 percent of outstanding FFELP loan volume in fiscal year 1995.

Sixteen of the 193 lenders with loan portfolios between \$5 million and \$10 million submitted audit reports that contained findings requiring corrective action. Lenders with portfolios of this size do not have to submit audit reports to the Department unless they contain these kinds of findings. The 16 audit reports contained 31 findings covering such areas as missing documents in loan files, incorrect billing calculations, and improper classifications of loans. Three reports had findings with a monetary impact—collectively, the Department owed lenders \$8,751. As of January 1997, all but 1 of the 16 lenders had taken corrective action.

### BACKGROUND

FFELP is the largest federal student loan program. Under the program, participating lenders make loans to eligible borrowers. The Department, through state-designated agencies, guarantees the loans against default. In fiscal year 1995, lenders made FFELP loans that totaled nearly \$22 billion.

For some time, the Congress and the Department have considered how audit requirements should apply to FFELP lenders. The 1992 amendments required every FFELP lender to obtain an annual audit examining compliance with program rules and regulations. However, lenders with smaller student loan portfolios complained that the cost of conducting the audit could exceed their profit on the portfolios. Fiscal years' 1996 and 1997 appropriations acts directed the Department not to use federal funds to enforce the audit requirement for lenders with annual loan portfolios of \$5 million or less.

Two bills introduced in the 104th Congress proposed a more permanent legislative revision than the temporary change contained in the two appropriations acts. Both bills would have amended the Higher Education Act to eliminate audits of lenders with loan portfolios of \$10 million or less. The topic remains under congressional consideration as the 105th Congress begins deliberating the reauthorization of the Higher Education Act.

PROPOSED CHANGE IN THRESHOLD  
WOULD AFFECT A SMALL PORTION OF  
FFELP LENDERS AND LOAN VOLUME

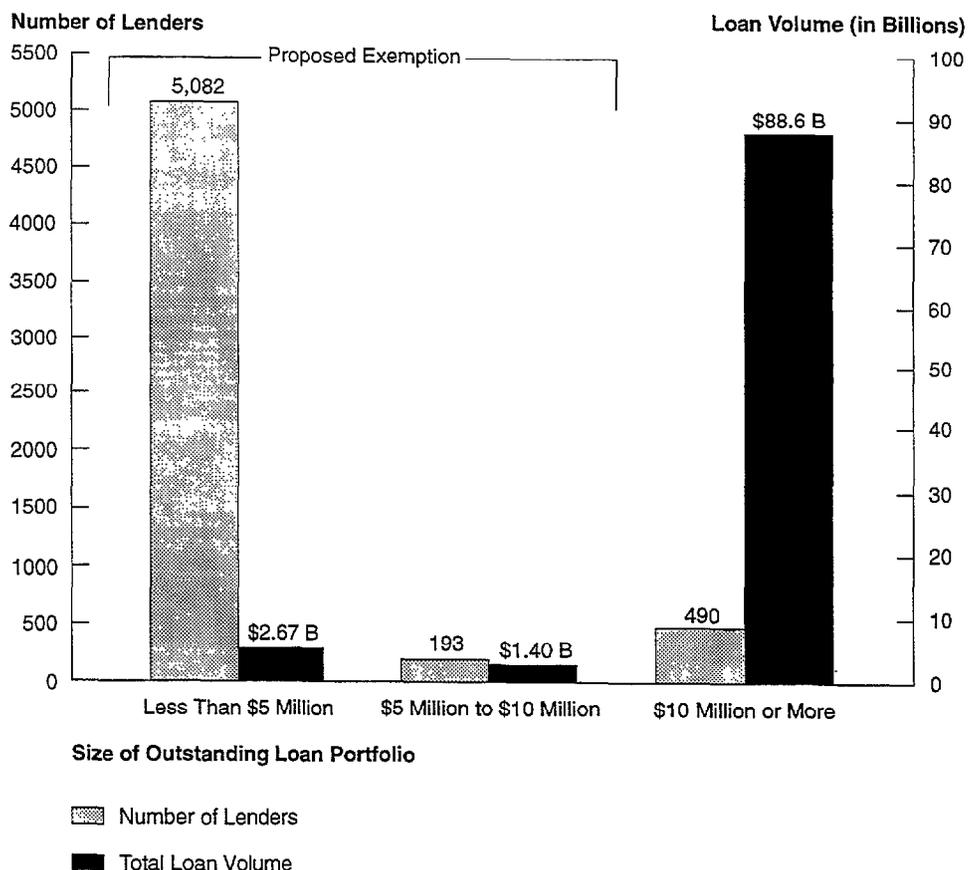
Lenders with outstanding loan portfolios between \$5 million and \$10 million constitute a relatively small portion of FFELP lenders. Department of Education records show that as of September 30, 1995, 5,765 lenders were participating in FFELP.<sup>1</sup> Of these, 193 lenders (3.3 percent) had portfolios between \$5 million and \$10 million. In comparison, about 88 percent of lenders had loan portfolios of less than \$5 million (accounting for 2.9 percent of the total amount of outstanding loans), and current appropriations law excludes them from the audit requirement.

Lenders with FFELP portfolios between \$5 million and \$10 million also held a small portion of the total amount of outstanding loans. In aggregate, these lenders' portfolios had about \$1.4 billion in FFELP loans, about 1.5 percent of the \$93 billion in FFELP loans held by all lenders at the end of fiscal year 1995. By contrast, the relatively few lenders with loan portfolios of \$10 million or more held nearly 96 percent of outstanding FFELP loans. Thus, as figure 1 shows, (1) the current audit requirement extends to relatively few lenders, but covers the vast majority of loan volume, and (2) audit coverage would not be appreciably changed if the audit threshold was raised to \$10 million.

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<sup>1</sup>This figure is based on the number of lender identification numbers contained in "Lender's Interest and Special Allowance Request and Reports" (ED form 799) on file with the Department as of September 30, 1995. The actual number of lenders may be somewhat lower than 5,765, according to Department officials, because some lenders, especially those with large volumes of loans, may have more than one identification number.

**Figure 1: Distribution of Lenders and Their Loan Volume by Size of Lender Portfolios in Fiscal Year 1995**



**LENDERS WITH PORTFOLIOS UNDER \$10 MILLION SUBMITTED FEW AUDIT REPORTS CONTAINING FINDINGS**

The Department requires lenders that have loan portfolios above \$5 million to have audits conducted. And the Department instructed lenders with portfolios between \$5 million and \$10 million to submit their audit reports to the Department by September 30, 1995, only if their reports issued for the previous 2 years contained findings that require corrective action. The Department received audit reports from 16 lenders whose loan portfolios were within the \$5 million and \$10 million threshold, and that had audits requiring corrective

action in calendar years 1993 or 1994.<sup>2</sup> The aggregate loan portfolio for these lenders was about \$95 million and \$117 million, respectively, in calendar years 1993 and 1994.

The 16 audit reports contained 31 findings that required corrective action. The number of findings in each report ranged from one (seven lenders) to four (two lenders). The Department classified the 31 findings into 15 categories, as shown in table 1. The most common finding (noted in four reports) was the improper recording of prior-period adjustments of special allowance payments.<sup>3</sup> For this finding, the audit reports questioned whether lenders properly recorded billing codes and used the correct loan principal and billing days.

Table 1: Audit Report Findings, by Category, Calendar Years 1993 and 1994

Finding	Frequency
Prior period special allowance adjustments were improperly recorded.	4
Form 799 (Lender's Interest and Special Allowance Request and Report) information did not agree with information in lender's summary accounting records.	3
Form 799 contained improperly classified loan types or incorrect loan status.	3
Lender's loan files missing documents required to support form 799.	3
Form 799 showed inaccurate average daily balances of loans in lender's portfolio.	3

<sup>2</sup>Department guidance provides that reports from the initial round of compliance audits were to be submitted by September 30, 1995, and were to cover the 2 years ending December 31, 1994.

<sup>3</sup>Special allowance is a payment of interest on a student loan that the government makes to lenders when borrowers' interest rates do not meet a certain level of return, as provided by the Higher Education Act of 1965, as amended.

Form 799 showed lender's improper recording of prior-period adjustment of interest benefits.	3
Form 799 did not agree with loan disbursement, origination fee, or loan fee records.	2
Form 799 contained inaccurate information on change in loan principal and analysis of loan portfolio.	2
Form 799 loan information did not agree with billing information provided by third-party loan servicer.	2
Lender improperly calculated loan origination fees.	1
Lender did not stop billing the Department for interest payments on the same date the loan entered repayment.	1
Lender misclassified loan or used improper time period for special allowance billing on form 799.	1
Lender improperly calculated loan balances using a monthly rather than a daily average.	1
Lender failed to exclude from form 799 special allowance billings for loans that had outstanding loan servicing violations.	1
Lender did not adequately segregate duties (for internal control purposes) in its student lending operation.	1
<b>Total findings</b>	<b>31</b>

The Department's review of the 16 audit reports identified three lenders whose findings had questioned the dollar amount paid to lenders. The audits showed that two of these lenders owed the Department \$5,168 and \$4,809, respectively. However, the audit of the third lender revealed that the lender understated the interest payment it was due by \$18,728. As a result, the net impact of the findings noted in the three reports was that the Department owed lenders an additional \$8,751.

As of January 1997, the Department had verified that 15 of the 16 lenders had taken corrective action as specified in the audit reports. A Department review showed that the remaining lender had not completed its corrective action plan, which called for five actions to improve the data the lender reported to the Department. The Department's review also uncovered several other deficiencies that were not noted in the audit report, such as the lender failing to pay about \$9,500 in required lender fees to the Department. Department

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officials have requested the Department's Office of Inspector General to further review this case and the work of the lender's independent auditor.

To help ensure that lenders with loan portfolios between \$5 million and \$10 million comply with Department requirements, in February 1997 the Department requested copies of audit reports from 25 randomly selected lenders from this group. As of April 30, 1997, the Department had received all but two of the requested reports, and its evaluation of these reports indicated that lenders had complied with the lender audit requirement.

AGENCY COMMENTS

On April 18, 1997, the Department of Education provided comments on a draft of this correspondence. The Department agreed with our correspondence and provided a number of technical comments, which we incorporated where appropriate.

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We are sending copies of this correspondence to appropriate congressional committees, the Secretary of Education, and other interested parties.

If you have any questions about this correspondence, please contact me on (202) 512-7014. Major contributors included Joseph J. Eglin, Jr., Assistant Director; Robert B. Miller; and Charles M. Novak.

Sincerely yours,



Carlotta C. Joyner  
Director, Education and  
Employment Issues

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